IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
SOUTHERN INTERNATIONAL, L.P.,	§	CASE NO. 99-34131-SAF-7
	§	
D E B T O R.	§	

MEMORANDUM OPINION AND ORDER

Dean Fuller, attorney for Southern International, L.P., moves the court for the final allowance of fees and reimbursement of expenses. Thomas V. Malorzo of the law firm of Bennett, Weston & LaJone, attorney for S.I. Import, Inc., and World of Fans, Inc., also moves the court for the final allowance of fees and reimbursement of expenses. HSBC Business Credit (USA), Inc., formerly known as HSBC Business Loans, Inc., opposes both motions. HSBC, in turn, moves the court for the turnover of its cash collateral held by the attorneys. The court conducted a hearing on HSBC's motion and Fuller's application on January 9, 2002. Following the hearing, the court provided for further briefing. The court conducted a hearing Malorzo's application on February 5, 2002.

The determination of compensation and reimbursement of expenses under §330(a) for professional persons employed under §327(a) and the determination of cash collateral issues constitute core matters over which this court has jurisdiction to enter a final order. 28 U.S.C. §§157(b)(2)(A), (M), (O), and 1334. This memorandum opinion contains the court's findings of fact and conclusions of law required by Bankruptcy Rules 7052 and 9014.

To determine reasonable compensation under §330(a) for the professional services rendered, the court must determine the "nature and extent of the services supplied by" the professional persons. 11 U.S.C. §330(a)(3); In re First Colonial Corporation of America, 544 F.2d 1291, 1299 (5th Cir. 1977). The court must also assess the value of those services in relation to the customary fee and quality of the legal work. These two factors comprise the components for the lodestar calculation. See Cobb v. Miller, 818 F.2d 1227, 1231 (5th Cir. 1987). Generally, the lodestar is calculated by multiplying the number of hours reasonably expended by reasonable hourly rates. Hensley v. Eckerhart, 461 U.S. 424, 434 (1983). The court may then adjust the compensation based on the factors of §§330(a)(3) and (4) and the Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 (5th Cir. 1974), factors. Blanchard v. Bergeron, 489 U.S. 87, 91-92, 94-95 (1989). The Johnson factors may be relevant for adjusting

the lodestar calculation but no one factor can substitute for the lodestar. Id. Rather, the lodestar shall be presumed to establish a reasonable fee with adjustments made when required by specific evidence. Pennsylvania v. Delaware Valley Citizens Council for Clean Air, 478 U.S. 546, 563-65 (1986).

Each applicant has the burden to show that its requested compensation is reasonable and was necessary for the proper administration of the estate. In re Beverly Manufacturing Corp., 841 F.2d 365, 371 (11th Cir. 1988). To assist the court in determining the reasonableness of the requested fees, the applicant is ethically obligated to exercise reasonable billing judgment. It must make a good faith effort to exclude from a fee request hours that are excessive, redundant, or otherwise unnecessary. Hensley, 461 U.S. at 434.

Fuller Application

Fuller seeks compensation for work performed from June 4, 1999, to January 10, 2000, the date that the court granted a motion to convert the cases from cases under Chapter 11 to cases under Chapter 7 of the Bankruptcy Code. Fuller's application also covers the work of his co-counsel, Jim Brouner. For ease of reference and because all of the contested matters substantially apply to Fuller's work, the court refers to the application as Fuller's application. Fuller originally requested total compensation and reimbursement of expenses of $66,828.11. To the

extent that Fuller's pleadings suggested that he requested compensation for work performed after the conversion to Chapter 7, Fuller has withdrawn that request. However, Fuller has not provided the court with a revised fee request. The court finds that Fuller reported 83 hours of work at $200 an hour after the date of conversion, totaling $16,600. Therefore, the court reduces Fuller's request by that amount, leaving $50,228.11 for the court's consideration.

The hourly rates charged by Fuller on this application fall within the prevailing rates in the Dallas and Fort Worth markets for similar services of attorneys of reasonably comparable skill, experience, and reputation. Therefore, the court finds that Fuller's hourly rate of $200 is reasonable. Missouri v. Jenkins, 491 U.S. 274, 286 (1989).

HSBC observes that Fuller did not provide a project billing analysis as required by the Guidelines for Compensation and Expense Reimbursement. See General Order No. 00-7 (Bankr. N.D. Tex. Dec. 21, 2000) (adopting Guidelines for Compensation and Expense Reimbursement of Professionals). Without that report, the court must reconstruct Fuller's project work from his time descriptions. Because he failed to provide his own accounting of work by project, Fuller must accept the inferences drawn by the court.

HSBC objects to Fuller's application by asserting that several time entries merely note telephone calls, conferences, research, and drafting without identifying the matter involved with sufficient clarity to demonstrate either the reasonableness of the charge or why the matter should not be considered non-billable overhead. These items include general background research on adequate protection, as well as conferences, telephone calls, and scheduling calls to the court or counsel. They also include charges for the employment applications. The cost of obtaining employment is not compensable. In the exercise of reasonable billing judgment, Fuller should have reduced his application by 5% to eliminate these items. The court disallows $2,511.00.

HSBC also objects to charges for drafting a proposed disclosure statement and a proposed plan of reorganization. However, even though the debtors and HSBC reached an impasse in their relationship in September 1999, the debtors continued: (1) to search for an alternate financing source; (2) to attempt to purchase inventory and thereupon operate its business; and (3) to formulate and pursue litigation against HSBC. Fuller reasonably pursued a Chapter 11 strategy based on those efforts.

The gravamen of HSBC's objections concerns who pays for Fuller's fees. The court addresses that issue in its consideration of HSBC's motion for a turnover of cash collateral.

Except as found above, the court finds Fuller's services reasonable. The court further finds that Fuller necessarily and actually incurred the expenses reported. The court, therefore, awards final compensation and reimbursement of expenses of $47,717.11 ($50,228.11 less $2,511).

Turnover

HSBC contends that, however reasonable the litigation may appear from the debtors' point of view, Fuller should not be paid from cash collateral to litigate with HSBC. Under the terms of the cash collateral orders, the debtors submitted weekly budgets to HSBC. The cash collateral orders authorized the debtors to use cash collateral for the budgeted items to meet the debtors' operational needs. The budgets included a line item for attorneys' fees. If HSBC approved the weekly budget, subject to the availability of cash collateral, then HSBC would transfer sufficient amounts into an operating account to fund the budget.

By an order entered August 12, 1999, the court authorized the debtors to transfer budgeted weekly attorney's fees to Fuller, "for depositing into his trust account on behalf of all of the Debtors and their respective attorneys of record, and subject to the filing of appropriate draw-down requests, interim fee applications and subject to final fee applications of all of the Debtors' attorneys, and to the extent necessary, and subject to an Order of this Court, such sums may be subject to

disgorgement." The court specifically provided that HSBC would retain the protections of the cash collateral orders with regard to the funds transferred to Fuller. Fuller received approximately $30,000 from the debtors pursuant to this procedure.

By an order entered August 11, 1999, the court granted HSBC a replacement lien under 11 U.S.C. §361 and §363(e) on assets of the debtors and property of the bankruptcy estates to the extent of the diminution in the value of HSBC's collateral. At the hearing on the motion to lift stay, the court found that HSBC's collateral had diminished in value. Therefore, the cash collateral transferred to Fuller is subject to this replacement lien. As provided in the August 12, 1999, order, cash transferred to Fuller was subject to return on order of the court on a final fee application. Upon order of return, the funds are impressed as property of the estate, subject to HSBC's replacement lien. Fuller contends that once drawn from his trust account, the property ceases to be property of the estate, thereby eliminating HSBC's replacement lien. But, that reading undermines the August 12, 1999, order's protections for HSBC and contravenes the policy of the Bankruptcy Code that property recovered by a trustee becomes property of the estate. See e.g., 11 U.S.C. §§329(b), 541(a)(3).

In the August 11, 1999, order, the court also provided that professional fees would be excluded from the adequate protections given to HSBC for the use of its cash collateral except for professional fees "related to (i) seeking to avoid or contest (but not the review and analysis of) the validity, non-avoidability, priority, extent or amount of HSBC's liens or indebtedness as provided for herein for the allowance of its claims, (ii) seeking to oppose HSBC's efforts to lift the automatic stay, or (iii) seeking to cramdown the interests of HSBC."

Fuller obtained a pre-petition $10,000 retainer. HSBC disclaimed an interest in the retainer funds. In the August 11, 1999, order the court directed that attorneys fees be paid first from the retainer, before seeking recourse against the debtors for payment.

HSBC contends that after September 9, 1999, Fuller's legal services amounted to attacks on HSBC and its secured position. HSBC argues that, as a result, Fuller may not apply HSBC's cash collateral to pay for the fees incurred after September 9, 1999. HSBC calculates that Fuller's fees up to September 9, 1999, total $19,276.95. HSBC states that Fuller should first apply the $10,000 retainer and then may apply $9,276.95 from the transferred cash collateral. But, Fuller must return the rest of the transferred cash collateral.

Fuller responds that HSBC waived any objection to his fees. He further argues that he should only be compelled to disgorge and return amounts for services found unreasonable by the court.

Although HSBC did not object to Fuller's retainer draw down requests, a draw down under L.B.R. 2016.1(b) does not constitute a final fee application under 11 U.S.C. §330(a). Consequently, the lack of an objection to the draw down of a retainer does not waive the right to object to a final fee application filed under §330(a).

Fuller also contends that HSBC waived its objection by funding the weekly budget for attorneys fees. But, the order entered August 12, 1999, preserves HSBC's right to object to a final fee application by making all payments subject to a final fee application under §330(a).

As to the $30,000 transferred to Fuller pursuant to the weekly cash collateral budgets, the order entered August 12, 1999, subjects them to disgorgement, while the order entered August 11, 1999, makes them subject to HSBC's adequate protection package for fees used to either challenge or litigate with HSBC in an adversary proceeding or in connection with a motion to lift the automatic stay. HSBC did not agree to either a blanket waiver of its adequate protections for funds transferred to Fuller or to fund litigation directed against it. Rather, as part of the cash collateral package, HSBC, in effect, agreed: (1)

to fund efforts by the debtor to maintain, reinvigorate, and restructure its business and financial affairs; (2) to continue operating; and (3) to confirm a plan of reorganization and thereby service its obligations to HSBC.

By a letter dated September 9, 1999, HSBC informed the debtors that, because of the deterioration of its collateral position, it would only authorize the use of cash collateral to pay essential expenses for the week of September 10, 1999. On September 10, 1999, HSBC filed a motion to lift the automatic stay.

Prior to that time Fuller's work had been focused on Chapter 11 reorganization efforts. But, after that time, the debtors and HSBC settled into an adversarial relationship. On November 16, 1999, the court conducted a hearing on the motion to lift stay. On January 10, 2000, the court converted the cases to cases under Chapter 7. So, the court analyzes Fuller's application from September 9, 1999, to January 10, 2000, to separate the HSBC adversarial matters from the other work performed by Fuller.

From September 13, 1999, to October 15, 1999, Fuller spent 8.6 hours regarding HSBC's motion to lift stay. At $200 an hour, that totals $1,720. HSBC maintains a replacement lien position and super-priority administrative expense adequate protections on the transferred funds. Therefore, HSBC cannot be compelled to pay for those services. From September 17, 1999, to October 1,

1999, Fuller spent 11.7 hours contesting cash collateral issues, which, at $200 an hour, totals $2,340. That excludes time spent reaching a limited agreement for the use of cash collateral for the one time purchase of inventory. Again, because HSBC maintains its adequate protections, HSBC cannot be compelled to pay for the adversarial cash collateral matters.

Beginning October 18, 1999, until the date of conversion, Fuller incurred 115.8 hours of services contesting HSBC's positions, including litigating the lift stay motion. At $200 an hour, that totals $23,160. Again, HSBC cannot be compelled to pay for that work.

However, the court does not accept HSBC's contention that all work after September 9, 1999, must be deemed adversarial to HSBC. The debtors did continue to attempt to reorganize and did attempt to locate alternate financing. Fuller's efforts in that regard facilitated that reorganization effort, without litigating with HSBC. For example, on October 20, 1999, Fuller spent three tenths of an hour working on direct sales and funding. Additionally, on October 21, 1999, Fuller spent one hour meeting with the client at the offices of a third party funder. That work furthers the reasons for the transfer of funds to Fuller under the August 12, 1999, order and protects Fuller's administrative expense position under the August 11, 1999, order.

The court concludes that Fuller incurred fees of $27,220

litigating against HSBC for which HSBC cannot be compelled to pay.

Applying that sum to the fees and expenses found reasonable by the court leaves $20,497.11 within the scope of the permitted use of cash collateral to further reorganization efforts, which HSBC agreed to fund.

The most significant portion of that work occurred before September 10, 1999, and comprises virtually all the allowed fees early in the case. Under the August 11, 1999, order, Fuller had to apply the $10,000 retainer before seeking recourse from the debtors. The court must therefore apply the $10,000 to the $20,497.11 amount. Fuller may seek recourse from the debtors for the remainder. Upon doing so, the order of August 12, 1999, becomes operable, allowing the use of cash collateral to pay the remaining $10,497.11.

Fuller holds approximately $30,000 transferred pursuant to the order of August 12,1999, but subject to the adequate protections of the order of August 11, 1999. Fuller may apply $10,497.11 to that $30,000, resulting in $19,502.89 to be paid to HSBC.[1]

With the payment of $20,497.11 of fees and expenses by application of the retainer and cash collateral, Fuller is owed

[1]The court defers to attorneys Fuller and Brouner for the manner of allotting payments between themselves.

$27,220. The court awards Fuller a Chapter 11 administrative expense of $27,220, to be subordinated to the payment of Chapter 7 administrative expenses.

In a colloquy with counsel during a hearing on March 28, 2000, the court questioned the effect of the transfer of cash to Fuller. The hearing of January 9, 2002, resolved those issues. HSBC does not claim an interest in the funds paid to Fuller as a pre-petition retainer. Additionally, HSBC does not seek a turnover of post-petition transfers to Fuller that pay for legal services rendered to the debtors in possession for efforts to reorganize that do not amount to contests against HSBC. For the remainder, the order of August 11, 1999, preserves a claim on those funds by HSBC as part of its adequate protection.

Fuller also contends that if the court finds his fees reasonable under §330(a), then the cash collateral should not be subject to a turnover order. But, that does not apply a common sense reading to the court's orders. HSBC did not agree to finance litigation against itself. HSBC agreed to the use of its cash collateral to attempt to reorganize a going concern business to allow HSBC to be paid, but not to be the target or subject of litigation. Consequently, from a lodestar analysis, Fuller's fees may be reasonable, but nevertheless not subject to payment by HSBC.

The court appreciates the difficulty of a sole practitioner paying the turn over order. But, HSBC is entitled to the payment. Counsel took the cash collateral knowing the risk. The court expects the parties to work together to accomplish the turnover.

Malorzo

Malorzo and his law firm, Bennett, Weston, & LaJone, request fees and expenses of $23,366.27 for S.I. Imports, Inc., and $8,600.32 for World of Fans, Inc., for a total of $39,966.59. For ease of reference, the court refers to Malorzo for his law firm. Malorzo received a pre-petition retainer totaling $3,000. He has received $3,000 under the cash collateral weekly budget procedure discussed above. Malorzo has not moved to draw down on these funds.

HSBC does not claim an interest in the $3,000 pre-petition retainer. HSBC objects to the allowance of any fees for Malorzo and moves for a turnover of the $3,000 transferred post-petition.

Southern International filed its bankruptcy petition on June 4, 1999. On that same day, Mark Bennett of Malorzo's law firm incorporated Fans & Lighting By Southern, Inc. According to its articles of incorporation, the corporation had the authority to issue 1,000 shares of common stock to Bennett. The articles of incorporation named William Edwards as the sole director. William Edwards is the father of Fred Edwards, the principal of

the debtor, S.I. Imports, Inc., and the affiliated debtor, Southern International, L.P. William Edwards is also the ex-husband of Iris Edwards, the principal of the debtor World of Fans, Inc., and Fred's mother. S.I. Imports imported goods primarily from the Far East. World of Fans and Southern sold those goods at retail. Fans & Lighting by Southern was intended to sell goods at retail. Four days later, on June 8, 1999, S.I. Import and World of Fans filed their bankruptcy petitions. All three debtors are affiliates. The father asserts a claim against the bankruptcy estates. In his statement of connections to the debtor, Malorzo did not disclose his firm's representation of Fans & Lighting By Southern, Inc.

"A professional person not eligible for employment under §327(a) may not be compensated under §330(a)." In re Southmark, 181 B.R. 291, 295 (Bankr. N.D.Tex. 1995). Compensation should not be allowed for services rendered by a professional person who represents an adverse interest to the estate even if no fraud or unfairness resulted from the conflict. Id. The incorporation of a competing company by an insider of the debtors contemporaneously with the filing of the bankruptcy petitions amounts to the representation of an interest adverse to the bankruptcy estates, precluding employment under 11 U.S.C. §327(a). Therefore, Malorzo's application is denied.

Malorzo contends that his firm does not represent an insider

of World of Fans, since Fred and Iris are divorced. However, ex-spouses remain insiders. In re Holloway, 955 F.2d 1008, 1014 (5th Cir. 1992). And Iris is the mother of Fred, William's son, and the principal of the other debtors. Malorzo also contends that Fans & Lighting by Southern did not compete with the debtors. While Fans & Lighting may not have competed with the import business of the debtors, it did or could have competed with the retail business.

The court further holds that non-disclosure of these relationships and connections should in and of itself preclude compensation.

HSBC does not claim an interest in the pre-petition retainer. The retainer is held in the Malorzo's firm trust account, as no draw down request has been made. The court has discussed with the parties the holding of Stewart v. Olson, 93 B.R. 91 (N.D. Tex. 1988). Funds transferred to an attorney by a debtor pre-petition and held in the attorney's trust account constitute property of the bankruptcy estate if not yet earned, and property of the attorney if earned. But, as applicable in the instant case, the funds had been transferred pre-petition to pay for bankruptcy services and cannot belong to the attorney until the entry of an order under §330(a) of the Bankruptcy Code. The debtors paid the retainer for bankruptcy representation, according to Malorzo's application. Consequently, the retainer

constitutes property of the bankruptcy estates. Malorzo paid the filing fees for the two cases, in the amount of $830 for each case. The pre-petition retainer, less reimbursement for the filing fees of $830 per application, shall be returned to the Chapter 7 trustee.

The $3,000 post-petition transfer has likewise remained in counsel's trust account, and has not been drawn down and applied to fees and expenses. Those funds remain subject to HSBC's adequate protections discussed above. Because Malorzo's application has been denied, the funds must be returned to the bankruptcy estates. Thereupon, the funds are impressed with HSBC's adequate protections and must be returned to HSBC.

In the Southmark decision cited above, this court summarized the legal standards for disgorgement of compensation. In the case of a disqualifying conflict,

> [a] total disgorgement of compensation could be required. Bankruptcy courts, however, usually assess compensation disgorgement issues under the particular facts of each case. While courts should tend to deny compensation when a professional person holds an interest adverse to the bankruptcy estate or is not disinterested, the court must nevertheless exercise discretion under the facts of a case to assure appropriate relief in complex circumstances. The court ultimately then must engage in a fact specific inquiry in which the court may balance benefit and/or harm to the estate, time and labor employed, egregiousness of the professional person's non-disclosure, and so forth.

Southmark, 181 B.R. at 296-97 (citations omitted).

Although HSBC has requested a turnover of funds and although the August 12, 1999, order references disgorgement, this case does not involve the disgorgement of fees. As used in the order and by HSBC, disgorgement refers to a return of cash collateral transferred to the attorneys, not to the disgorgement of fees paid by the debtors pursuant to court order. The funds held in counsel's trust account remain in the account, and have not been drawn down pursuant to L.B.R. 2016.1(b). The court has not awarded compensation or reimbursement of expenses to counsel under either 11 U.S.C. §330(a) or §331. Therefore, this case does not involve disgorging fees previously allowed or awarded by the court or permitted to be drawn from a retainer by a judicial procedure. Consequently, the Southmark discussion of a fact specific inquiry, for the determination of the amount of disgorgement of previously allowed fees after a disqualification finding, does not apply. The court, therefore, does not deviate from the general rule of disallowing fees. 181 B.R. at 295. Therefore, Malorzo shall return the $3,000 to HSBC.

In the event that an appellate court reverses this court's denial of compensation based on ineligibility for employment, the court makes these alternative findings regarding compensation. For S.I. Imports, Malorzo requests compensation of $23,430 and expenses of $1,936.27. The court finds Malorzo's hourly rate of $175 reasonable. As found in the Fuller application, Malorzo's

post-conversion work is not compensable from the bankruptcy estate. So the court focuses on pre-conversion work.

Malorzo spent 16.25 hours on Chapter 11 matters including the petition, schedules, meeting of creditors, discussions with creditors, etc. The court has excluded from that category of work, 2.5 hours of tasks billed at attorney rates, that should be billed at a paralegal rate of $50 per hour, such as faxing letters, compiling the mailing matrix, etc. Malorzo also spent 19.25 hours working on cash collateral matters before the debtors and HSBC settled into their adversary posture. Malorzo spent 47.25 hours of work litigating or related to litigation with HSBC. He also spent 2.5 hours on lease matters and 2.25 hours on a trucking dispute. The court finds that these activities would have benefitted the estate. That work totals $15,437.50.

The court disallows post-conversion time. The court also disallows work relating to obtaining employment, researching conflicts, general review of files, and inter-office conferences.

The court would recognize expenses of $1,915.37.

Therefore, if a reviewing court reversed the decision to deny fees because of ineligibility for employment, the court would award compensation of $15,437.50 and $1,915.37 for expenses, for a total of $17,352.87. Malorzo could apply the $2,000 pre-petition retainer and the $2,000 post petition cash collateral transfer to that amount, leaving $13,352.87 as a

Chapter 11 administrative expense. Under this analysis, a turnover to HSBC does not occur because the transfers are exhausted before reaching HSBC contested matters.

For World of Fans, Malorzo requests compensation of $7,242 and expenses of $1,358.32. Using a similar analysis, the court finds 15 hours of work relating to the Chapter 11 petition, schedules, meeting of creditors, meeting with United States Trustee, negotiating a settlement with a creditor, attending to business matters, and meeting with a potential lender. The court has separated 3 additional hours for matters that should have been billed at paralegal rates, such as compiling the matrix, faxing and refaxing, and transmittal letters. The court also finds reasonable 6.5 hours addressing cash collateral matters before the HSBC relationship became adversarial, and 10.35 following the change in the relationship. The court disallows time for obtaining employment, including employment as special counsel. The cost of obtaining employment is an overhead expense not billable to the client. The court also finds that reviewing a notice from the United States Trustee should not have been billed in the exercise of reasonable billing judgment.

Consequently, in the event of a reversal of the eligibility decision, the court would find compensation of $5,723.75 and expenses of $1,358.32, for a total of $7,082.07. Malorzo could apply the $1,000 pre-petition retainer and the $1,000 post-

petition transfer to that total, resulting in no turnover and a Chapter 11 administrative expense of $5,082.07.

Based on the foregoing,

IT IS ORDERED:

1. Dean Fuller is awarded final compensation and reimbursement of expenses of $47,717.11.

2. Dean Fuller shall have a Chapter 11 administrative expense in the Southern International case of $27,200.

3. The application of Thomas Malorzo is **DENIED.**

4. Thomas Malorzo shall return $170 to the Chapter 7 trustee of World of Fans, Inc., and $1,170 to the Chapter 7 trustee of S.I. Imports, Inc.

5. HSBC's second motion for turnover of cash collateral is **GRANTED IN PART and DENIED IN PART.**

6. Dean Fuller shall pay HSBC $19,502.89.

7. Thomas Malorzo shall pay HSBC $3,000.

Dated this _____ day of February, 2002.

Steven A. Felsenthal
United States Bankruptcy Judge